



[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 20

[REG-112196-07]

RIN 1545-BH64

Gross Estate; Election to Value on Alternate Valuation Date

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations that provide guidance respecting the election to use the alternate valuation method under section 2032 of the Internal Revenue Code (Code). The proposed regulations will affect estates that file Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return and elect to use the alternate valuation method. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by **[INSERT DATE 90 DAYS AFTER THIS DOCUMENT IS PUBLISHED IN THE FEDERAL REGISTER]**. Outlines of topics to be discussed at the public hearing scheduled for March 9, 2012, at 10:00 a.m. must be received by February 17, 2012.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-112196-07), Internal Revenue Service, Room 5203, PO Box 7604, Ben Franklin Station, Washington, DC

20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-112196-07), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW., Washington, DC 20224; or sent electronically via the Federal eRulemaking Portal at <http://www.regulations.gov> (IRS-REG-112196-07). The public hearing will be held in the Auditorium, beginning at 10 a.m., at the Internal Revenue Building, 1111 Constitution Avenue NW, Washington, DC. FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Theresa M. Melchiorre, (202) 622-3090; concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Richard Hurst at Richard.A.Hurst@irsounsel.treas.gov or at (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

Section 2001 imposes a tax on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States. Section 2033 provides that the value of the gross estate includes the value of all property to the extent of the interest of the decedent at the time of his death. Section 2031(a) provides that the value of the decedent's gross estate includes the value at the time of the decedent's death of all property, real or personal, tangible or intangible, wherever situated. Section 2032(a) provides that the value of the gross estate may be determined, if the executor so elects, by valuing all the property includible in the gross estate as follows. Property distributed, sold, exchanged, or otherwise disposed of during the 6-month period

immediately after the date of death (alternate valuation period) is valued as of the date of distribution, sale, exchange, or other disposition (transaction date). I.R.C. section 2032(a)(1). Property not distributed, sold, exchanged, or otherwise disposed of during the alternate valuation period is valued as of the date that is 6 months after the decedent's death (6-month date). I.R.C. section 2032(a)(2). Any interest or estate that is affected by the mere lapse of time is includible at its value as of the date of death (instead of any later date), with adjustment for any difference in its value as of the later date that is not due to the mere lapse of time. I.R.C. section 2032(a)(3).

Section 2031(c) was enacted by the Taxpayer Relief Act of 1997, 105 Public Law 34 section 508(a), 111 Stat. 788 (August 5, 1997). Pursuant to this section, a decedent's estate may elect to exclude from the gross estate a portion of the fair market value of property includible in the decedent's gross estate by granting a qualified conservation easement on that property after the date of the decedent's death but on or before the due date (including extensions) for filing the Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return.

On April 25, 2008, a notice of proposed rulemaking (Reg-112196-07) relating to amendments to the Estate Tax Regulations (26 CFR part 20) under section 2032 of the Code was published in the **Federal Register** (73 FR 22300). Those regulations (73 FR 22300) proposed to clarify that the election to use the alternate valuation method under section 2032 is available to estates that experience a reduction in the value of the gross estate during the alternate valuation period, but only to the extent that the reduction in value is due to market conditions and not to other post-death events (events occurring

during the alternate valuation period). The term "market conditions" was defined as events outside of the control of the decedent (or the decedent's executor or trustee) or other person whose property is being valued that affect the fair market value of the property includible in the decedent's gross estate. Changes in value due to mere lapse of time or to other post-death events would be ignored in determining the value of the decedent's gross estate under the alternate valuation method.

No hearing was held because no person or organization requested to speak at a hearing. However, written comments were received. Some commentators expressed concern that the proposed regulations (73 FR 22300) would create administrative problems because an estate would be required to trace property and to obtain appraisals based on hypothetical property. Some commentators stated that the current and the proposed regulations (73 FR 22300) did not adequately address the application of section 2032 to certain types of property, such as property the title to which passes at death due to contract, and to transactions carried out during the alternate valuation period between an estate and partnerships, corporations, or other entities. For example, §20.2032-1(c)(1) does not address the consequences of the estate contributing property to a partnership during the alternate valuation period.

In addition, commentators requested guidance on the effect of a section 2032 election in calculating the portion of a trust includible in the decedent's gross estate under section 2036. This would arise in the situation where the decedent had retained the right to an annuity, unitrust, or other payment from the trust for life, for any period not ascertainable without reference to the grantor's death, or for a period that does not

in fact end before the grantor's death. Further, some commentators requested guidance on the treatment of the grant, during the alternate valuation period, of a qualified conservation easement under section 2031(c).

Many commentators acknowledged that estates may enter into a transaction during the alternate valuation period that could result in the abuse of the section 2032 election. They suggested that the IRS and Treasury Department would better serve taxpayers and address any potential abuse by ensuring that the regulations address the issues described in this preamble rather than finalizing the approach taken in the proposed regulations.

In view of the comments, the Treasury Department and the IRS are withdrawing the proposed regulations (73 FR 22300) by the publication of these proposed regulations in the **Federal Register**. Nevertheless, see the background section of those proposed regulations (73 FR 22300) for a summary of the legislative history of section 2032 and the purpose for issuing these proposed regulations.

This document contains revised proposed amendments to the regulations promulgated under section 2032. These proposed regulations make irrelevant, for purposes of determining the value of property as of the transaction date or the 6-month date, whichever is applicable (alternate valuation date), the percentage of ownership or control in an entity includible in the gross estate and the extent of participation by the estate (or other holder of property includible in the gross estate) in the relevant post-death events.

Certain provisions in the current regulations that have been in effect since 1954

are restated in the proposed regulations for purposes of clarity. The effective date of those provisions is not changed.

Explanation of Provisions

These regulations propose to amend several sections of §20.2032-1. Generally, paragraph (c)(1)(i) identifies transactions that constitute distributions, sales, exchanges, or dispositions of property. If an estate's (or other holder's) property is subject to such a transaction during the alternate valuation period, the estate must value that property on the transaction date. The value included in the gross estate is the fair market value of that property on the date of and immediately prior to the transaction. The term "property" refers to the property includible in the decedent's gross estate under section 2033.

Sections 20.2032-1(c)(1)(ii) and (c)(1)(iii)(A) identify two exceptions to the rule in §20.2032-1(c)(1)(i). If either exception applies, the estate may use the 6-month date and value the property held on that date. The exception in §20.2032-1(c)(1)(ii) applies only to transactions in which an interest in a corporation, partnership, or other entity (entity) includible in the decedent's gross estate is exchanged for one or more different interests (for example, a different class of stock) in the same entity or in an acquiring or resulting entity or entities during the alternate valuation period. Such transactions may include, without limitation, reorganizations, recapitalizations, mergers, or similar transactions. This exception substitutes a fair market value test for the corporate provisions in the current regulations. Specifically, this paragraph proposes that, if, during the alternate valuation period, the interest in an entity includible in the gross

estate is exchanged for a different interest in the same entity, or in an acquiring or resulting entity or entities, and if the fair market value of the interest on the date of the exchange equals the fair market value of the property for which it was exchanged, then the transaction will not be treated as an exchange for purposes of section 2032(a)(1). As a result, the estate may use the 6-month date to value the interest in the same entity or in the acquiring or resulting entity or entities received in the exchange. For this purpose, the fair market values of the surrendered property and received interest are deemed to be equal if the difference between the fair market values of the surrendered property and the received interest does not exceed 5 percent of the fair market value of the surrendered property as of the transaction date. This section has no effect on any other provision of the Code that is applicable to the transaction. For example, the provisions of chapter 14 may apply even if the transaction does not result in a deemed exchange for section 2032 purposes as a result of satisfying the provisions of §20.2032-1(c)(1)(ii).

Section 20.2032-1(c)(1)(iii)(A) proposes that, if, during the alternate valuation period, an estate (or other holder) receives a distribution from a business entity, bank account, or retirement trust (entity) and an interest in that entity is includible in the decedent's gross estate, the estate may use the 6-month date to value the property held in the estate if the following requirement is satisfied. The fair market value of the interest in the entity includible in the gross estate immediately before the distribution must equal the sum of the fair market value of the distributed property on the date of the distribution and the fair market value of the interest in the entity includible in the gross

estate immediately after the distribution. If this requirement is not satisfied, the estate must use the fair market value as of the distribution date and immediately prior to the distribution of the entire interest in the entity includible in the gross estate. For purposes of this section, any distribution is deemed to consist first of excluded property (as defined in §20.2032-1(d)), if any, and then of included property.

Section 20.2032-1(c)(1)(iv) proposes an aggregation rule to use in calculating the fair market value of each portion of property that is, or is deemed to be distributed, sold, exchanged, or otherwise disposed of during the alternate valuation period, and that remains in the gross estate on the 6-month date.

Section 20.2032-1(c)(iii)(B) provides a special rule to use in determining the portion of a trust includible, by reason of a retained interest, in the decedent's gross estate under section 2036 as of the alternate valuation date. An example is added to §20.2032-1(e) to illustrate this special rule and the effect of the provisions of §20.2032-1(d) and §20.2032-1(f)(2)(i) on this calculation.

Section 20.2032-1(c)(2) is amended to clarify when property, the title to which passes by contract or by operation of law, is deemed to be distributed, sold, exchanged, or otherwise disposed of for section 2032 purposes. Section 20.2032-1(c)(3) is amended to clarify the person or entity that will be treated as having sold, exchanged, or otherwise disposed of the property for section 2032 purposes.

Section 20.2032-1(c)(4) is added to provide that if Congress, by statute, has deemed that a post-death event has occurred on the decedent's date of death, the post-death event will not result in a distribution, sale, exchange, or other disposition of the

property for section 2032 purposes. To date, the only post-death event that satisfies this exception is the grant, during the alternate valuation period, of a conservation easement in accordance with section 2031(c). With respect to such a grant, for section 2032 purposes, the estate must determine the fair market value of the property as of the date of death and as of the alternate valuation date, taking into account the effect of the easement on each of those valuation dates.

Section 20.2032-1(c)(5) provides examples, not intended to be exclusive, illustrating the provisions of §20.2032-1(c).

Section 20.2032-1(f) is revised to clarify the types of factors that impact the fair market value of property and the effect of which will be recognized under section 2032. This paragraph also explains and illustrates these rules.

Proposed Effective/Applicability Date

Section 20.2032-1(c)(2) except the second sentence of the introductory text, §20.2032-1(c)(3) except §20.2032-1(c)(3)(i)(C), the chart in Example 1 of §20.2032-1(e), §20.2032-1(f)(2) except the last sentence, and the first and third sentences in §20.2032-1(f)(2)(ii) are applicable to decedents dying after August 16, 1954. Sections 20.2032-1(a) introductory text, 20.2032-1(a)(1), 20.2032-1(a)(2), 20.2032-1(c)(1)(i), (c)(1)(ii), (c)(1)(iii), (c)(1)(iv), (c)(3)(i)(C), (c)(4), (c)(5), (f)(1), (f)(2)(i), and (f)(3), the second sentence in §20.2032-1(c)(2) introductory text, §20.2032-1(e) except the chart in Example 1, the last sentence in §20.2032-1(f)(2) introductory text, and the second sentence in §20.2032-1(f)(2)(ii) are applicable to estates of decedents dying on or after the date of publication of the Treasury decision adopting these rules as final in the

Federal Register.

Special Analyses

It has been determined that this proposed regulation is not a significant regulatory action as defined in Executive Order 12866, as supplemented by Executive Order 13563. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations and, because these regulations do not impose on small entities a collection of information requirement, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury Department also request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for March 9, 2012 at 10:00 a.m. in Auditorium, Internal Revenue Building. Due to building security procedures, visitors must use the main building entrance 1111 Constitution Avenue NW, Washington, DC.

In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For more information about having your name placed on the list to attend the hearing, see the “FOR FURTHER INFORMATION CONTACT” section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written (a signed original and eight (8) copies) or electronic comments by **[INSERT DATE 90 DAYS AFTER THIS DOCUMENT IS PUBLISHED IN THE FEDERAL REGISTER]** and an outline of the topics to be discussed and the time to be devoted to each topic by February 17, 2012. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these proposed regulations is Theresa M. Melchiorre, Office of Associate Chief Counsel (Passthroughs and Special Industries).

List of Subjects in 26 CFR Part 20

Estate taxes, Reporting and recordkeeping requirements.

Withdrawal of Notice of Proposed Rulemaking

Under the authority of 26 U.S.C. 7805, the notice of proposed rulemaking (Reg-112196-07) that was published in the **Federal Register** on April 25, 2008 (73 FR

22300) is withdrawn.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 20 is proposed to be amended as follows:

PART 20--ESTATE TAX; ESTATES OF DECEDENTS DYING AFTER AUGUST 16, 1954

Paragraph 1. The authority citation for part 20 continues to read in part as follows:

Authority: 26 U. S. C. 7805 * * *

§20.2032-1[AMENDED]

Par. 2. For each entry in the table, each paragraph in the “Old Paragraph” column is redesignated as indicated in the “New Paragraph” column:

Old Paragraph	New Paragraph
20.2032-1(c)(1)	20.2032-1(c)(1)(i)
20.2032-1(c)(3)	20.2032-1(c)(3)(i)
20.2032-1(c)(3)(i)	20.2032-1(c)(3)(i)(A)
20.2032-1(c)(3)(ii)	20.2032-1(c)(3)(i)(B)
20.2032-1(c)(3)(iii)	20.2032-1(c)(3)(i)(C)
20.2032-1(c)(3)(iv)	20.2032-1(c)(3)(i)(D)
20.2032-1(c)(3)(v)	20.2032-1(c)(3)(i)(E)
20.2032-1(f)	20.2032-1(f)(2)
20.2032-1(f)(1)	20.2032-1(f)(2)(i)
20.2032-1(f)(2)	20.2032-1(f)(2)(ii)

Par. 3. Section 20.2032-1 is amended by:

1. Revising paragraph (a) introductory text.
2. Revising paragraphs (a)(1) and (a)(2).
3. Revising newly-designated paragraph (c)(1)(i), newly-designated paragraph (c)(3)(i)(C), paragraph (e) introductory text, the introductory text of paragraph (e) Example 1 preceding the table, the last sentence in newly-designated paragraph (f)(2) introductory text, newly-designated paragraph (f)(2)(i), and the second sentence in newly-designated paragraph (f)(2)(ii).
4. Adding new paragraphs (c)(1)(ii), (c)(1)(iii), (c)(1)(iv), (c)(4), (c)(5), (f)(1), and (f)(3).
5. Adding a paragraph heading and a new second sentence in paragraph (c)(2) introductory text.
6. Adding a paragraph heading to paragraph (c)(3).
7. Designating the undesignated language following newly-designated paragraph (c)(3)(i)(E) as paragraph (c)(3)(ii) and adding a paragraph heading to this paragraph.
8. Designating the table in paragraph (e) as Example 1 and adding paragraph (e) Example 2 following the table.
9. Revising the paragraph heading and adding two sentences at the end of paragraph (h).

The additions and revisions read as follows.

§20.2032-1 Alternate valuation.

(a) In general. – In general, section 2032 provides for the valuation of a decedent's gross estate at a date (alternate valuation date) other than the date of the decedent's death. More specifically, if an executor elects the alternate valuation method under section 2032, the property includible in the decedent's gross estate on the date of death (decedent's interest) is valued as of whichever of the following dates is applicable:

(1) Any property distributed, sold, exchanged, or otherwise disposed of within 6 months (1 year, if the decedent died on or before December 31, 1970) after the decedent's death (alternate valuation period) is valued as of the date on which it is first distributed, sold, exchanged, or otherwise disposed of (transaction date).

(2) Any property not distributed, sold, exchanged, or otherwise disposed of during the alternate valuation period is valued as of the date 6 months (1 year, if the decedent died on or before December 31, 1970) after the date of the decedent's death (6-month date).

* * * * *

(c) Meaning of "distributed, sold, exchanged, or otherwise disposed of"—(1) In general.

(i) Transactions included. The phrase “distributed, sold, exchanged, or otherwise disposed of” comprehends all possible ways by which property ceases to form a part of the gross estate. This phrase includes, but is not limited to:

(A) The use of money on hand at the date of the decedent's death to pay funeral

or other expenses of the decedent's estate;

(B) The use of money on hand at the date of the decedent's death to invest in other property;

(C) The exercise of employee stock options;

(D) The surrender of stock for corporate assets in partial or complete liquidation of a corporation, and similar transactions involving partnerships or other entities;

(E) The distribution by the estate (or other holder) of included property as defined in paragraph (d) of this section;

(F) The transfer or exchange of property for other property, whether or not gain or loss is currently recognized for income tax purposes;

(G) The contribution of cash or other property to a corporation, partnership, or other entity, whether or not gain or loss is currently recognized for income tax purposes;

(H) The exchange of interests in a corporation, partnership, or other entity (entity) for one or more different interests (for example, a different class of stock) in the same entity or in an acquiring or resulting entity or entities (see, however, paragraph (c)(1)(ii) of this section); and

(I) Any other change in the ownership structure or interests in, or in the assets of, a corporation, partnership, or other entity, an interest in which is includible in the gross estate, such that the included property after the change does not reasonably represent the included property at the decedent's date of death (see, however, paragraph (c)(1)(iii)(A) of this section). Such a change in the ownership structure or interests in or in the assets of an entity includes, without limitation--

(1) The dilution of the decedent's ownership interest in the entity due to the issuance of additional ownership interests in that entity;

(2) An increase in the decedent's ownership interest in the entity due to the entity's redemption of the interest of a different owner;

(3) A reinvestment of the entity's assets; and

(4) A distribution or disbursement of property (other than excluded property as defined in paragraph (d) of this section) by the entity (other than expenses, such as rents and salaries, paid in the ordinary course of the entity's business), with the effect that the fair market value of the entity before the occurrence does not equal the fair market value of the entity immediately thereafter.

(ii) Exchange of an interest in an existing corporation, partnership, or other entity includible in the gross estate. If an interest in a corporation, partnership, or other entity (entity) is includible in the gross estate at death and that interest is exchanged as described in paragraph (c)(1)(i)(H) of this section for one or more different interests in the same entity or in an acquiring or resulting entity or entities, the transaction does not result in an exchange or disposition under section 2032(a)(1) and paragraph (c)(1)(i)(H) of this section if, on the date of the exchange, the fair market value of the interest in the entity equals the fair market value of the interest(s) in the same entity or the acquiring or resulting entity or entities. Such transactions may include, without limitation, reorganizations, recapitalizations, mergers, or similar transactions. In determining whether the exchanged properties have the same fair market value, a difference in value equal to or less than 5 percent of the fair market value, as of the transaction date,

of the property interest includible in the gross estate on the decedent's date of death is ignored. If the transaction satisfies the requirements of this paragraph, the property to be valued on the 6-month date (or on the transaction date, if any, subsequent to this transaction) is the property received in the exchange, rather than the property includible in the decedent's gross estate at the date of death. This paragraph has no effect on any other provision of the Internal Revenue Code that is applicable to the transaction. For example, even if the transaction does not result in a deemed exchange as a result of satisfying the requirements of this paragraph, the provisions of chapter 14 may be applicable to determine fair market value for Federal estate tax purposes.

(iii) Distributions from an account or entity in which the decedent held an interest at death.

(A) In general. If during the alternate valuation period, an estate (or other holder of the decedent's interest) receives a distribution or disbursement (to the extent the distribution or disbursement consists of included property, as defined in paragraph (d) of this section) (payment) from a partnership, corporation, trust (including an IRA, Roth IRA, 403(b), 401(k), Thrift Savings Plan, etc.), bank account or similar asset, or other entity (entity), and an interest in that entity is includible in the gross estate, the payment does not result in a distribution under paragraph (c)(1)(i)(I) of this section. However, this rule applies only if, on the date of the payment, the fair market value of the decedent's interest in the entity before the payment equals the sum of the fair market value of the payment made to the estate (or other holder of the decedent's interest in the entity) and the fair market value of the decedent's interest in the entity, not including

any excluded property, after the payment. In this case, the alternate valuation date of the payment is the date of the payment, and the alternate valuation date of the decedent's remaining interest in the entity, if any, is the 6-month date (or the transaction date, if any, subsequent to this payment). If this requirement is not met, the payment is a distribution under paragraph (c)(1)(i) of this section, and the alternate valuation date of the decedent's entire interest in the entity is the date of the payment. For purposes of this section, a distribution or disbursement is deemed to consist first of excluded property, if any, and then of included property, as those terms are defined in paragraph (d) of this section.

(B) Special rule. If the decedent's interest in an entity that is includible in the gross estate consists of the amount needed to produce an annuity, unitrust, remainder, or other such payment valued under section 2036, then assuming the distribution satisfies the general rule set forth in paragraph (c)(1)(iii)(A) of this section, the value of each distribution (to the extent it is deemed to consist of included property) payable (whether or not actually paid) during the alternate valuation period shall be added to the value of the entity on the alternate valuation date. The sum of the fair market value of these distributions when made and the fair market value of the entity on the alternate valuation date shall be used as the fair market value of the entity in computing the amount, valued as of the alternate valuation date, to be included in the decedent's gross estate under section 2036. See Example 2 of paragraph (e) of this section.

(iv) Aggregation. For purposes of this section, a special aggregation rule applies in two situations to determine the value to be included in the gross estate pursuant to an

alternate valuation election. Those two situations arise when, during the alternate valuation period, less than all of the interest includible in the decedent's gross estate in a particular property is the subject of a transaction described in paragraphs (c)(1)(i), (c)(1)(ii), (c)(1)(iii), or (c)(2) of this section. In one situation, one or more portions of the includible interest are subject to such a transaction and a portion is still held on the 6-month date. In the other situation, the entire interest includible in the gross estate is disposed of in two or more such transactions during the alternate valuation period, so that no part of that interest remains on the 6-month date. In both of these situations, the fair market value of each portion of the interest includible in the gross estate is to be determined as follows. The fair market value of each portion subject to such a transaction, and the portion remaining, if any, on the 6-month date, is the fair market value, as of the transaction date, or the 6-month date for any remaining portion, of the entire interest includible in the gross estate on the decedent's date of death, multiplied by a fraction. The numerator of that fraction is the portion of the interest subject to that transaction, or the portion remaining on the 6-month date, and the denominator is the entire interest includible in the gross estate at the decedent's date of death.

(2) Property distributed. * * * Property is not considered "distributed" merely because property passes directly at death as a result of a beneficiary designation or other contractual arrangement or by operation of law. * * *

(3) Person able to sell, exchange, or otherwise dispose of property includible in the gross estate. (i) * * *

(A) * * *

(B) * * *

(C) An heir, devisee, or other person to whom title to property passes directly on death by reason of a beneficiary designation or other contractual arrangement or by operation of law;

(D) * * *

(E) * * *

(ii) Binding contracts. * * *

(4) Certain post-death events. If the effect of any other provision of the Internal Revenue Code is that a post-death event is deemed to have occurred on the date of death, the post-death event will not be considered a transaction described in paragraph (c)(1)(i) of this section. For example, the grant, during the alternate valuation period, of a qualified conservation easement in accordance with section 2031(c) is not a transaction described in paragraph (c)(1)(i) of this section. Pursuant to section 2031(c), the post-death grant of the easement is effective for Federal estate tax purposes as of the date of the decedent's death. As a result, for purposes of determining both the estate's eligibility to make an election under this section and the value of the property on the alternate valuation date, the fair market value of the property as of the date of death must be compared to the fair market value of that property as of the alternate valuation date, in each case as that value is adjusted by reason of the existence of the section 2031(c) qualified easement.

(5) Examples. The application of paragraph (c) of this section is illustrated in the following examples. In each example, decedent's (D's) estate elects to value D's gross

estate under the alternate valuation method, so that the alternate valuation date of the property includible in the gross estate on D's date of death is either the transaction date or the 6-month date. In each example, assume that the only factors affecting value during the alternate valuation period, and the only occurrences described in paragraphs (c)(1)(i) and (c)(2) of this section, are those described in the example.

Example 1. At D's death, D owned property with a fair market value of \$100X. Two months after D's death (Date 1), D's executor and D's family members formed a limited partnership. D's executor contributed all of the property to the partnership and received an interest in the partnership in exchange. The investment of the property in the partnership is a transaction described in paragraph (c)(1)(i)(F) and/or (G) of this section. As a result, the alternate valuation date of the property is the date of its contribution and the value to be included in D's gross estate is the fair market value of the property immediately prior to its contribution to the partnership. The result would be the same if D's estate instead had contributed property to a limited partnership formed prior to D's death by D and/or other parties, related or unrelated to D. Further, the result would be the same if D's estate had contributed the property to a corporation, publicly traded or otherwise, or other entity after D's death and prior to the 6-month date.

Example 2. At D's death, D held incentive stock options that were qualified under section 422. D's executor exercised all of the stock options prior to the 6-month date. The exercise of the stock options is a transaction described in paragraph (c)(1)(i)(C) of this section. Thus, the alternate valuation date of the stock options is the date of their exercise and the value to be included in D's gross estate is the fair market value of the stock options immediately prior to their exercise. The result would be the same if the stock options were not qualified under section 422 and were taxable under section 83 upon exercise.

Example 3. D's gross estate includes a controlling interest in Y, a corporation. During the alternate valuation period, Y issued additional shares of stock and awarded them to certain key employees. D's interest in Y was diluted to a non-controlling interest by Y's issuance of the additional stock. Y's issuance of the stock is a transaction described in paragraph (c)(1)(i)(I) of this section. The value to be included in D's gross estate is the fair market value of D's stock immediately prior to Y's issuance of the additional stock. The result would be the same if D's estate included a minority interest in Y on the date of death and that interest became a controlling interest during the alternate valuation period as the result of Y's redemption of the shares of another shareholder.

Example 4. At D's death, D owned stock in Y, a corporation. During the

alternate valuation period, the Board of Directors of Y contributed all of Y's assets to a partnership in exchange for interests therein. The contribution is a transaction described in paragraph (c)(1)(i)(I)(3) of this section. Therefore, the alternate valuation date of D's stock in Y is the date of the reinvestment of Y's assets and the value to be included in D's gross estate is the fair market value of D's stock in Y immediately prior to the reinvestment. The result would be the same even if the Board of Directors had contributed only a portion of Y's assets to the partnership during the alternate valuation period.

Example 5. (i) At D's death, D owned common stock in Y, a corporation. Two months after D's death (Date 1), there was a reorganization of Y. In the reorganization, D's estate exchanged all of its stock for a new class of stock in X. On the date of the reorganization, the difference between the fair market value of the stock D's estate received and the fair market value on that date of the stock includible in D's gross estate at death was greater than 5% of the fair market value, as of the date of the reorganization, of the stock D held at death. The reorganization is a transaction described in paragraph (c)(1)(i)(H) of this section and does not satisfy the exception described in paragraph (c)(1)(ii) of this section. Thus, the alternate valuation date is the date of the reorganization and the value to be included in D's gross estate is the fair market value of the stock immediately prior to the reorganization. This result is not affected by whether or not the reorganization is a tax-free reorganization for Federal income tax purposes. The result would be the same if the stock had been held, for example, in an IRA with designated beneficiaries. See paragraph (c)(3)(i)(C) of this section.

(ii) If, instead, the difference between the two fair market values as of the date of the reorganization was equal to or less than 5% of the fair market value, as of the date of the reorganization, of the stock D held at death, the reorganization would satisfy the exception provided in paragraph (c)(1)(ii) of this section. Thus, the alternate valuation date would be the 6-month date. The value to be included in D's gross estate would be the fair market value, determined as of the 6-month date, of the new class of stock in Y that D's estate received in the reorganization.

Example 6. (i) At D's death, D owned an interest in Partnership X that is includible in D's gross estate. During the alternate valuation period, X made a cash distribution to each of the partners. The distribution consists entirely of included property as defined in paragraph (d) of this section. The distribution is a transaction described in paragraph (c)(1)(i)(I)(4) of this section. On the date of the distribution, the fair market value of D's interest in X before the distribution equaled the sum of the distribution paid to D's estate and the fair market value of D's interest in X immediately after the distribution. Thus, pursuant to paragraph (c)(1)(iii)(A) of this section, the alternate valuation date of the property distributed is the date of the distribution, and the alternate valuation date of D's interest in X is the 6-month date.

(ii) If, instead, the fair market value of D's interest in X before the distribution did not equal the sum of the distribution paid to D's estate and the fair market value of D's interest in X (not including any excluded property) immediately after the distribution, then pursuant to paragraph (c)(1)(i)(I)(4) of this section, the alternate valuation date of D's entire interest in X would be the date of the distribution.

Example 7. D died owning 100% of Blackacre. D's will directs that an undivided 70% interest in Blackacre is to pass to Trust A for the benefit of D's surviving spouse, and an undivided 30% interest is to pass to Trust B for the benefit of D's surviving child. Three months after D's death (Date 1), the executor of D's estate distributed a 70% interest in Blackacre to Trust A. Four months after D's death (Date 2), the executor of D's estate distributed a 30% interest in Blackacre to Trust B. The following values are includible in D's gross estate pursuant to paragraphs (c)(1)(i)(E) and (c)(1)(iv): the fair market value of the 70% interest in Blackacre, determined by calculating 70% of the fair market value of all (100%) of Blackacre as of Date 1; and the fair market value of the 30% interest in Blackacre, determined by calculating 30% of the fair market value of all (100%) of Blackacre as of Date 2.

Example 8. At D's death, D owned 100% of the units of a limited liability company (LLC). Two months after D's death (Date 1), D's executor sold 20% of the LLC units to an unrelated third party. Three months after D's death (Date 2), D's executor sold 40% of the LLC units to D's child. On the 6-month date, the estate held the remaining 40% of the units in the LLC. The alternate valuation date of the units sold is their sale date (Date 1 and Date 2, respectively) pursuant to paragraph (a) of this section. The alternate valuation date of the units remaining in the estate is the 6-month date, as these units have not been distributed, sold, exchanged, or otherwise disposed of in a transaction described in paragraphs (c)(1)(i) or (c)(2) of this section prior to this date. Pursuant to paragraph (c)(1)(iv) of this section, the value of the units disposed of on Date 1 and Date 2 is the fair market value of the 20% and 40% interests, determined by calculating 20% and 40% of the fair market value as of Date 1 and Date 2, respectively, of all the units (100%) includible in the gross estate at D's death. Similarly, the value of the units held on the 6-month date to be included in D's gross estate is the fair market value of those units, determined by taking 40% of the fair market value on the 6-month date of all of the units (100%) includible in the gross estate at D's death. As a result, the fact that the partial sales resulted in the creation of three minority interests is not taken into account in valuing under section 2032 any portion of the LLC interests held by D at D's death.

Example 9. Husband died owning an interest in a brokerage account titled in the names of Husband and Wife with rights of survivorship. On Husband's death, the account held marketable securities, corporate bonds, municipal bonds, certificates of deposit, and cash. During the alternate valuation period, Wife's stockbroker advised her that the account could not be held under the social security number of a deceased individual. Accordingly, approximately one month after Husband's death, Wife directed

the stockbroker to transfer the account into an account titled in Wife's sole name. Because title to the joint account passes to Wife at the moment of Husband's death by operation of law, the transfer of the joint account into an account in Wife's sole name is not a transaction described in paragraph (c)(1)(i) of this section. Accordingly, the value of the assets held in Wife's solely owned account will be includible in Husband's gross estate at their fair market value on the 6-month date. The result would be the same if the brokerage firm automatically transferred title to the account into Wife's name, or if Wife changed the beneficiary designation for the account. Finally, the result would be the same if, instead of an account with a brokerage firm, the assets were held in Husband's retirement account (IRA or similar trust such as a Roth IRA, 403(b) plan, or 401(k) plan) or Wife's ownership of the account was the result of a contract (a beneficiary designation form) rather than operation of law.

Example 10. Assume the same facts as in Example 9 except that, during the alternate valuation period, Wife directed the stockbroker to sell a bond in the account. The sale is a transaction described in paragraph (c)(1)(i)(I)(4) of this section. Wife is an individual described in paragraph (c)(3)(i)(D) of this section. Thus, the alternate valuation date of the bond is the date of its sale. The values to be included in D's gross estate are the fair market value of the bond on date of its sale, and the fair market value of the balance of the account on the 6-month date. The result would be the same if the bond had matured and was retired during the alternate valuation period. The result also would be the same if the bond was held within a retirement account (IRA or similar trust such as a Roth IRA, 403(b) plan, or 401(k) plan).

Example 11. Assume the same facts as in Example 9 except that, during the alternate valuation period, Wife withdrew cash from the account or otherwise received income or other disbursements from the account. Each such withdrawal or disbursement from the account (to the extent it consists of included property as defined in paragraph (d) of this section) is a distribution described in paragraph (c)(1)(i)(I)(4) of this section. Provided that, on the date of each distribution, the fair market value of the account before the distribution (not including excluded property) equals the sum of the included property distributed and the fair market value of the included property in the account immediately after the distribution in accordance with paragraph (c)(1)(iii)(A) of this section, the alternate valuation date for each distribution is the date of the distribution and the alternate valuation date for the account is the 6-month date. The value to be included in the gross estate is the fair market value of each distribution of included property (determined as of the date of distribution) and the fair market value of the account on the 6-month date. The result would be the same if the assets were held in an IRA or similar trust, such as a Roth IRA, 403(b) plan, or 401(k) plan.

Example 12. Husband died with a retirement account, having named his three children, in specified shares totaling 100%, as the designated beneficiaries of that account. During the alternate valuation period, the account was divided into three separate retirement accounts, each in the name of a different child and funded with that

child's designated share. The division of the retirement account is not a transaction described in paragraph (c)(1)(i) of this section by reason of paragraph (c)(2) of this section, so the alternate valuation date for each of the new accounts is the 6-month date.

Example 13. (i) D's gross estate includes real property. During the alternate valuation period, D's executor grants a conservation easement that restricts the property's use under local law but does not satisfy the requirements of section 2031(c). The easement reduces the fair market value of the property. The executor's grant of the conservation easement is a transaction described in paragraph (c)(1)(i)(E) of this section and does not satisfy the exception described in paragraph (c)(4) of this section. Therefore, the alternate valuation date for the property is the date the easement was granted, and the value to be included in D's gross estate is the fair market value of the property immediately prior to the grant.

(ii) Assume, instead, that the easement satisfied the requirements of section 2031(c) and, thus, satisfied the exception described in paragraph (c)(4) of this section. Pursuant to paragraph (c)(4), for purposes of determining both the estate's eligibility to make an election under section 2032 and the value of the property on the 6-month date, the section 2031(c) qualified easement is taken into account in determining both the fair market value of the property on D's date of death and the fair market value of the property on the 6-month date.

* * * * *

(e) Examples. –The application of paragraph (d) of this section regarding “included property” and “excluded property” is illustrated by the following examples.

Example 1. Assume that the decedent (D) died on January 1, 1955: * * *

Example 2. (i) At death, D held a qualified interest described in section 2702(b) in the form of an annuity in a grantor retained annuity trust (GRAT) D had created and funded with \$150,000. The trust agreement provides for an annual annuity payment of \$12,000 per year to D or D's estate for a term of 10 years. At the expiration of the 10-year term, the remainder is to be distributed to D's child. D dies prior to the expiration of the 10-year term. On D's date of death, the fair market value of the property in the GRAT is \$325,000.

(ii) The only assets in the GRAT are an apartment building and a bank account. Three months after D's date of death, an annuity payment of \$12,000 is paid in cash to D's estate. The monthly rents from the apartment building total \$500. After the date of death and prior to the payment date, the GRAT received \$1,500 in excluded property in the form of rent. Pursuant to paragraph (c)(1)(iii)(A) of this section, \$1,500 of the

\$12,000 distributed is deemed to be excluded property for purposes of section 2032. The distribution is a transaction described in paragraph (c)(1)(i)(I)(4) of this section. On the date of the distribution, the fair market value of D's interest in the GRAT before the distribution equals the sum of the distribution paid to D's estate and the fair market value of D's interest in the GRAT immediately after the distribution. Thus, pursuant to paragraph (c)(1)(iii)(A) of this section, the alternate valuation date for the \$10,500 cash distribution, which is included property, is the date of its distribution, and the alternate valuation date of the GRAT is the 6-month date.

(iii) The calculation of the value of D's interest in the GRAT includible in D's gross estate at D's death pursuant to section 2036 must be computed under the special rule of paragraph (c)(1)(iii)(B) of this section as a result of the estate's election to use the alternate valuation method under section 2032. On the 6-month date, the section 7520 interest rate is 6% and the fair market value of the property in the GRAT is \$289,500. Pursuant to paragraph (c)(1)(iii)(B) of this section, the fair market value of the GRAT property deemed to be included property is \$300,000 (\$289,500 plus \$10,500). Accordingly, for purposes of determining the fair market value of the corpus includible in D's gross estate under section 2036(a)(1) as of the 6-month date, see §20.2036-1(c)(2), using a GRAT corpus of \$300,000 and, pursuant to paragraph (f)(2)(i) of this section, a section 7520 rate of 6%.

(f) Post-death factors and occurrences.—(1) In general. The election to use the alternate valuation method under section 2032 permits property includible in the gross estate on the decedent's date of death to be valued on the 6-month date, rather than on the date of death. Thus, the election permits a valuation for Federal estate tax purposes that reflects the impact of factors such as economic or market conditions, occurrences described in section 2054 (to the extent not compensated by insurance or otherwise, and not deducted under that section), and other factors or occurrences during the alternate valuation period, as set forth in guidance issued by the Secretary. Those factors and occurrences do not include the mere lapse of time described in paragraph (f)(2) of this section, or transactions described in paragraph (c)(1)(i) or (c)(2) of this section that are not excluded under paragraphs (c)(1)(ii), (c)(1)(iii)(A), and (c)(4) of this section. Generally, management decisions made in the ordinary course of

operating a business, such as a corporation, a partnership, or other business entity, are taken into account under this section as occurrences related to economic or market conditions. To the extent, however, that these decisions change the ownership or control structure of the business entity, or otherwise are included in paragraph (c)(1)(i) or (c)(2) of this section and are not excluded by paragraphs (c)(1)(ii), (c)(1)(iii)(A), or (c)(4) of this section, they will be treated as described in paragraph (c)(1)(i) of this section.

(2) Mere lapse of time. * * * The application of this paragraph is illustrated in paragraphs (f)(2)(i) and (f)(2)(ii) of this section:

(i) Life estates, remainders, and similar interests. (A) The fair market value of a life estate, remainder, term interest or similar interest as of the alternate valuation date is determined by applying the methodology prescribed in §20.2031-7, subject to the following two sentences. The age of each person whose life expectancy may affect the fair market value of the interest shall be determined as of the date of the decedent's death. The fair market value of the property and the applicable interest rate under section 7520 shall be determined using values applicable on the alternate valuation date.

(B) Examples. The application of paragraph (f)(2)(i)(A) of this section is illustrated in the following examples.

Example 1. Assume that the decedent (D) or D's estate was entitled to receive certain property upon the death of A, who was entitled to the income from the property for life. At the time of D's death after April 30, 2009, the fair market value of the property was \$50,000, and A was 47 years and 5 months old. In the month in which D died, the section 7520 rate was 6.2%, but rose to 7.4% on the 6-month date. The fair market value of D's remainder interest as of D's date of death was \$9,336.00 (\$50,000 x

0.18672, the single life remainder factor from Table S for a 47 year old at a 6.2% interest rate), as illustrated in Example 1 of §20.2031-7T(d)(5). If, because of economic conditions, the property declined in value during the alternate valuation period and was worth only \$40,000 on the 6-month date, the fair market value of the remainder interest would be \$5,827 ($\$40,000 \times 0.14568$, the Table S value for a 47 year old at a 7.4% interest rate), even though A would have been 48 years old on the 6-month date.

Example 2. D created an *intervivos* charitable remainder annuity trust (CRAT) described in section 664(d)(1). The trust instrument directs the trustee to hold, invest, and reinvest the corpus of the trust and to pay to D for D's life, and then to D's child (C) for C's life, an amount each year equal to 6% of the initial fair market value of the trust. At the termination of the trust, the corpus, together with the accumulated income, is to be distributed to N, a charitable organization described in sections 170(c), 2055(a), and 2522(a). D died, survived by C. D's estate is entitled to a charitable deduction under section 2055 for the present value of N's remainder interest in the CRAT. Pursuant to §1.664-2(c) and §20.7520-2, in determining the fair market value of the remainder interest as of the alternate valuation date, D's executor may elect to use the section 7520 rate in effect for either of the two months immediately preceding the month in which the alternate valuation date occurs. Regardless of the section 7520 rate selected, however, the factor to be used to value the remainder interest is the appropriate factor for C's age on the date of D's death.

(2)(ii) Patents. * * * Six months after the date of the decedent's death, the patent was sold for its then fair market value that had decreased to \$60,000 because of the lapse of time. * * *

(3) Examples. The following examples illustrate the application of this paragraph (f). In each example, decedent's (D's) estate elects to value D's gross estate under the alternate valuation method, so that the alternate valuation date of the property includible in the gross estate on D's date of death is either the transaction date or the 6-month date. In each example, assume that the only factors affecting value, and the only occurrences described in paragraph (c)(1)(i) or (c)(2) of this section, taking place during the alternate valuation period are those described in the example.

Example 1. At D's death, D's gross estate includes a residence. During the alternate valuation period, the fair market value of the residence (as well as the

residential market in the area generally) declines due to a reduction in the availability of credit throughout the United States and, consequently, a decline in the availability of mortgages. The decline in the availability of mortgages is an economic or market condition. Therefore, in valuing the residence on the 6-month date, the effect of this decline on the fair market value of the residence is to be taken into account.

Example 2. (i) At D's death, D is the sole shareholder of corporation Y, a manufacturing company. Four months after D's death, Y's physical plant is destroyed as a result of a natural disaster. The disaster affects a large geographic area and, as a result, the economy of that area is negatively affected. Five months after D's death, Y's Board of Directors votes to liquidate and dissolve Y. The liquidation and dissolution proceeding is not completed as of the 6-month date. The natural disaster is a factor that affects economic and market conditions. Therefore, the disaster, to the extent not compensated by insurance or otherwise, is taken into account in valuing the Y stock on the 6-month date.

(ii) Assume instead that Y's plant is severely damaged due to flooding from the failure of pipes in the facility. The damage is an occurrence described in section 2054. Therefore, the damage, to the extent not compensated by insurance or otherwise, is taken into account in valuing the property on the 6-month date.

Example 3. At D's death, D has an interest in an S corporation, W. During the alternate valuation period, it is discovered that an employee of W has embezzled significant assets from W. W does not reasonably expect to recover the funds or any damages from the employee, and insurance proceeds are not sufficient to cover the loss. The theft is an occurrence described in section 2054. Therefore, the theft, to the extent not compensated by insurance or otherwise, is taken into account in valuing D's interest in W on the 6-month date.

(h) Effective/applicability date. * * * All of paragraph (c)(2) of this section except the second sentence of the introductory text, all of paragraph (c)(3) of this section except paragraph (c)(3)(i)(C) of this section, the chart in Example 1 of paragraph (e) of this section, all of paragraph (f)(2) of this section except the last sentence, and the first and third sentences in paragraph (f)(2)(ii) of this section are applicable to decedents dying after August 16, 1954. All of paragraphs (a) introductory text, (a)(1), (a)(2), (c)(1)(i), (c)(1)(ii), (c)(1)(iii), (c)(1)(iv), (c)(3)(i)(C), (c)(4), (c)(5), (f)(1), (f)(2)(i), and (f)(3) of this section, the second sentence of the introductory text in paragraph (c)(2) of this section, all of paragraph (e) of this section except the chart in Example 1, the last sentence in the introductory text of paragraph (f)(2) of this section, and the second sentence in paragraph (f)(2)(ii) of this section are applicable to estates of decedents dying on or after the date of publication of the Treasury decision adopting these rules as final in the **Federal Register**.

Steven T. Miller

Deputy Commissioner for Services and Enforcement

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